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Financial Markets

Irving Trust

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Economic Research &
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Friday
(Noon)

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Over the past four weeks, the money and capital markets have undergone a substantial backup. Yields on three-month CDs have risen by about 100 basis points, while the yield on the government long bond has moved up by 55 basis points. Over this same period, the effective rate for Fed funds (a rate weighted by the volume of transactions at each level) has risen by 35 basis points. On the face of it, these statistics do not give strong support to the notion that the Fed is tightening policy--money market rates have zoomed up far faster than the funds rate. But then why have rates firmed? Has the Fed been responsible?

To a great extent the market has put rates up in advance of strong action by the Fed. Yet this does not mean that the Fed is not responsible or that the rise in rates is undesired. Market participants have come to see the overly rapid growth of M1 as something the Fed is unlikely to ignore. Thus they have acted in anticipation of Fed reaction. But this situation is not clear cut--a number of Fed officials have been quoted recently saying conflicting things about the importance of M1.

Perhaps the clearest sign of Fed intentions occurred on Wednesday, June 1. On that last day of the reserve maintenance period, the Fed executed a System RP, adding reserves to the banking system, thereby alleviating some pressure on the Fed funds rate. Occurring on Wednesday, as it did, the transaction indicates a rate preference by the Fed. Late in the statement week, the Fed has very accurate reserve projections and can be fairly sure of the banking system's reserve position. However, one unexpected development was the large holding by banks of excess reserves, $5.4 billion on Wednesday. The Fed did not know about this at the time; all it could see was the rate pressure. Rate pressure emerged because the excess reserves held at some banks were unavailable for use at banks that were reserve deficient. The RP accommodated the demand for excess reserves by the banking system by allowing reserve deficient banks to purchase reserves in the market rather than forcing borrowing from the Fed. The decision to trade off nonborrowed reserve path goals for interest rate goals is notable.

The accommodative posture by the Fed would seem to indicate a Fed policy more attuned to interest rates than to a nonborrowed reserve path--at least at some level of rates. The Fed executed the RP with Fed funds at 9 3/8%, making it seem as though the Fed was protecting the 9 1/2% level. Thus the Fed seems willing to allow Fed funds to trade somewhat above 9% without reaction--this is a definite change from the general 8 1/2%-8 3/4% range that had existed. Still, the market is concerned that these rates could go higher. Indeed, if the Fed really wishes to tighten--to gain control of M1--rates must be pushed up far higher. This is something I don't think the Fed will do. However, it will keep rates on the firm side as long as money growth is a problem. An added element is that M2 and M3 are going to look a little worse to the Fed than they have so far this year. The Fed's room to maneuver, therefore, is being restricted, and the market clearly perceives that.

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Market Yields

	6/10/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.75	8.63	14.25
Repurchase Agreements	8.63	8.63	13.63
U.S. Treasury Issues			
Bills			
3 months	9.04	8.84	12.40
6 months	9.36	9.20	13.08
1 year	9.59	9.39	13.50
Coupons			
2 years	10.10	10.02	13.80
4 years	10.45	10.38	14.01
7 years	10.80	10.74	14.10
10 years	10.83	10.78	13.90
Long Bond	10.92	10.92	13.82
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.00	8.80	13.70
3 months	9.25	8.95	13.80
6 months	9.50	9.20	14.05
1 year	9.95	9.55	14.15
Banker's Acceptances			
1 month	9.05	8.87	13.90
3 months	9.30	9.00	13.90
6 months	9.50	9.16	14.10
Eurodollar Deposits			
1 month	9.38	9.13	14.38
2 months	9.50	9.25	14.63
3 months	9.63	9.38	14.88
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.89	8.76	13.86
1 month	9.19	8.94	13.84
3 months	9.34	9.07	13.89
Bank Holding Companies			
1 month	9.07	8.81	13.58
Dealer Placed:			
3 months	9.39	9.04	13.89
New AA Corporate Utility Bond	11.80	11.70	16.35
Tax Exempt			
6 month Project Notes	4.95	4.95	7.80
1 year AAA Bond	5.55	5.50	8.15
5 year AAA Bond	7.00	7.00	9.50
20 year AAA Bond	9.50	9.50	11.75

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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